

March 2, 1998

MEMORANDUM FOR A-AA/M, RICHARD C. NYGARD

FROM: IG/A/I7

IG/A/ITSA, Theodore P. Aives JOHN

SUBJECT:

Audit of the Extent to Which USAID's Financial Management System Meets

Requirements Identified in the Federal Financial Management Improvement

Act of 1996 (Audit Report No. A-000-98-003-P)

This report shows that USAID has not implemented and maintained a financial management system that complies substantially with (1) federal financial management system requirements, (2) applicable federal accounting standards, and (3) the United States Standard General Ledger at the transaction level as required by Section 803 (a) of the Federal Financial Management Improvement Act of 1996. As a result, USAID managers do not always receive the complete, reliable, timely, and consistent information they need to reliably report financial or performance results or efficiently manage agency operations. USAID accurately reported this condition in its fiscal year 1997 Federal Managers' Financial Integrity Act report, and is taking action to implement a financial management system that complies with these requirements.

The purposes of this report are to provide senior USAID managers (1) a description of the nature and importance of the requirements for an effective Federal financial management system as outlined in Section 7 of Office of Management and Budget Circular No. A-I 27, and (2) the impact on agency operations from not meeting the requirements. We expect this report to serve as a baseline, against which USAID's progress in correcting the system deficiencies can be measured. Because these deficiencies have been previously reported and USAID is taking action to implement prior Office of Inspector General recommendations to correct the problems, this report contains no additional recommendations. Appendix III lists previous Office of Inspector General audit reports as well as USAID management analyses that have identified these deficiencies.

Thank you for the cooperation and assistance extended to our auditors during this assignment.

Background

The Federal Financial Management Improvement Act of 1996 (PC 104-208) requires that agencies implement and maintain financial management systems that comply substantially with federal financial management system requirements, applicable federal accounting standards, and the United States Standard General Ledger at the transaction level (SGL)¹. The Act also requires, beginning with the fiscal year 1997 audit of agency financial statements, that auditors report whether the agency's financial management system complies with these system and accounting requirements.² If the system is found not to be compliant, the report is to address the nature and extent of noncompliance, the cause of noncompliance, the organization responsible for noncompliance, comments from responsible officials, and recommendations to correct the deficiencies.' We met this requirement in our report on USAID's compliance with laws and regulations, which is one component of our fiscal year 1997 financial statement audit.⁴

The Congress found, among other things, that federal financial management and fiscal practices do not (1) identify costs fully; (2) reflect total liabilities of congressional actions; or (3) accurately report the financial condition of the federal government. The FFMIA calls on agencies to improve their financial management systems so that all assets, liabilities, revenues and expenditures, and the full cost of programs and activities can be consistently and accurately recorded, monitored, and uniformly reported.

¹ The SGL provides **a** standard chart of accounts and standardized transactions that agencies are to use in all their financial systems.

² OMB calls on agencies to implement a single integrated financial management system, which is a unified set of financial systems and the financial portion of mixed systems that are used to carry out financial management functions; manage financial operations; and report financial information to central management agencies, the Congress, and the public.

³ The Act also requires the agency head to make a determination whether the agency's financial management system substantially complies with the requirements. If the agency head determines that the system does not comply, a remediation plan is required. Generally, the plan should bring the system into compliance within three years. Inspectors' General are then required to report to Congress if the agency does not meet the target dates identified in the plan.

Report No. 0-000-98-001-F, dated March 2, 1997, Reports on USAID's Financial Statements. Internal Controls, and Compliance for Fiscal Years 1997 and 1996.

Requirements for Financial Management Systems

Financial management system requirements are designed to enable agencies to provide complete, reliable, timely, and consistent information to decision makers and the public. Agencies, including Treasury and OMB, need this information to (1) carry out their fiduciary responsibilities; (2) deter fraud, waste, and abuse; (3) facilitate efficient and effective delivery of programs; and (4) hold agency managers accountable for the way government programs are managed. The Congress needs this information to oversee government operations, and the public, to exercise their citizenship responsibilities. Thus, a key objective of financial management systems is to ensure that reliable financial and program performance data are obtained, maintained, and reported. Federal policy is to establish government-wide financial management systems and compatible agency systems to accomplish these objectives.

The three system requirements identified in the FFMIA-federal requirements for financial management systems, applicable accounting standards, and the SGL at the transaction level-are detailed in OMB's Circular No. A-127, Financial Management Systems. Section 7 of this Circular identifies 12 categories of requirements that a financial management system should meet to operate effectively. Other policy documents further detail these requirements, including Office of Management and Budget's Circulars No. A-1'30, Management of Federal Information Resources, No. A-1 34, Financial Accounting Principles and Standards, No. A-I 1, Preparation and Submission of Budget Estimates, and No. A-34, Instructions on Budget Execution; and the Treasury Department's Treasury Financial Manual. In particular, the Joint Financial Management Improvement Program (JFMIP) has published several documents describing detailed functional requirements that systems should possess to perform effectively.

For purposes of this report and in order to better describe the interrelationships among the 12 requirements contained in OMB Circular A-127, we grouped the requirements into four categories as shown in the following table.

FEDERAL FINANCIAL MANAGEMENT SYSTEMS		
Category	Requirements	
Accounting	 Classification structure Integrated system Application of U.S. Government Standard General Ledger at the transaction level Federal Accounting Standards Functional requirements (i.e., JFMIP) 	
Reporting	Financial reporting (including performance measures)Budget reporting	
Controls.	 Internal controls Computer Security Act requirements 	
Operations	DocumentationTraining and user supportMaintenance	

Audit Objective:

This audit was designed to answer the following objective:

Did USAID implement and maintain a financial management system that complies substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Government Standard General Ledger at the transaction level?

This report describes the requirements within each category, the importance of implementing the requirements, the extent to which current systems meet the requirements, and the impact noncompliance has had on USAID management's ability to accomplish its management and reporting requirements. A full description of our scope and methodology is contained in Appendix I.

Audit Findings

USAID's System Does Not Meet Federal Reauirements

USAID's financial management system does not substantially comply with federal financial management system requirements, including requirements to apply applicable accounting standards, and the SGL at the transaction level.

These deficiencies have hindered USAID for a number of years. A series of reports by the Office of Inspector General (OIG) and the General Accounting Office (GAO), as well as USAID management assessments, have disclosed numerous financial and management problems that were caused by ineffective financial management systems. Since 1988, USAID has reported the lack of an effective, integrated financial management system as a material weakness under the Federal Managers' Financial Integrity Act (Integrity Act).

Although USAID has made several attempts to correct these deficiencies, it has not yet succeeded. Most recently, USAID developed a new integrated financial management system, called the New Management System (NMS), which was deployed worldwide in October 1996. This system was designed to replace aging and ineffective computer systems that USAID uses to perform accounting, budgeting, procurement, and operational functions. This new system was also expected to comply with all federal requirements for financial management systems.

During fiscal year 1997, however, we issued several reports identifying technical and operational problems that prevented NMS from operating effectively.' In large part, because the core accounting component of NMS has not operated effectively, USAID has had to rely on a combination of legacy systems, informal and unofficial records maintained by individual managers or organizational units, and the new system. Our reports, as well as studies and analyses conducted by USAID, show that, throughout fiscal year 1997, USAID's financial management system did not substantially comply with the 12 characteristics listed in Section 7 of the Office of Management and Budget's Circular No. A-127.

⁵ Audit Report No. A-000-97-004-P, March 31, 1997, <u>Audit of the Worldwide Deployment of the New Management System(NMS)</u>; Audit Report No. A-000-97-005-P, July 11, 1997, <u>Audit of USAID's Efforts to Resolve the Year 2000 Problem</u>; Audit Report No. A-000-97-008-P, September 30, 1997, <u>Audit of USAID's Compliance with Federal Computer Security Requirements:</u> Audit Report No. A-000-97-009-P, September 30, 1997, <u>Audit of the Internal Controls for the Operational New Management System</u>; and , Audit Report No. A-000-97-010-P, September 30, 1997, <u>Audit of the Status of USAID's New Management System(NMS)</u>.

USAID recognizes that, because' its financial management system does not incorporate the FFMIA's requirements, managers do not always receive the information they need to reliably report financial or performance results or efficiently manage agency operations. In addition, our audit of fiscal year 1997 financial statements found numerous material internal control weaknesses, due in large part to financial management system deficiencies. In this regard, USAID's fiscal year 1997 Integrity Act report identified six material weaknesses that cause various adverse financial and operational problems.

USAID has not been able to implement these requirements because it lacks effective information resources management (IRM) processes. Both USAID's Chief Financial Officer (CFO) and Chief Information Officer (CIO) share organizational responsibility for the ineffective IRM processes. USAID management recognizes that effective IRM processes are essential to implement systems that meet FFMIA requirements, and has begun taking steps to strengthen its organizational control over information technology investments. USAID also identified ineffective IRM processes as a material weakness in the Fiscal Year 1997 Integrity Act report.

In February 1998, USAID issued an agency-wide notice describing its disappointment with the performance of NMS and committing to implement a financial management system that complies with federal standards and can produce an auditable consolidated financial statement. USAID managers are currently analyzing alternative ways to implement a financial management system that meets federal requirements. Current estimates are that the system deficiencies will not be corrected until fiscal year 2000, but these estimates may change when the alternatives analysis is complete and a detailed plan is prepared.

The following table summarizes the extent to which USAID's financial management system complies with federal system requirements.

Compliance With Federal System Requirements				
System Requirement	Indicators of the Status of Compliance: Fiscal Year 1997			
Information Classification Structure	USAID relies on a combination of legacy systems, informal records, and NMS. Because these systems do not contain standard data definitions or formats, USAID lacks an agency-wide classification structure.			
Integrated System	Because USAID relies on multiple incompatible systems that are not able to exchange data, it does not have an integrated system.			
United States Standard General Ledger at the Transaction Level	Several major categories of transactions are not supported by the United States Standard General Ledger at the transaction level.			
Applicable Federal Accounting Standards	NMS does not include an automated accrual function which is an accounting standard that is required to be automated by JFMIP.			
Financial Reporting	USAID has identified financial reporting as a material internal control weakness in its fiscal year 1997 Integrity Act report.			
Budget Reporting	USAID's Office of Financial Management reported that obligations exceeded the appropriated amount in two cases in fiscal year 1997: That Office believes that the reports of over-obligations are the result of double recording of obligations rather than an actual over-obligation.			
Functional Requirements [JFMIP]	NMS has not been tested to determine its compliance with functional requirements, but USAID reports identify numerous important JFMIP reauirements that have not been met.			
Computer Security Act	We reported in September 1997, that USAID had not implemented an effective computer security program. USAID identified its computer security program and NMS computer security as material weaknesses in its fiscal year 1997 Integrity Act report.			
Documentation	USAID has reported incomplete NMS source code and identified the lack of financial management policies as a material weakness in its fiscal year 1997 Integrity Act report.			
Internal Controls	We reported in September 1997, that the NMS did not have a system of internal controls that met federal government standards.			
Training and User Support	In March 1997, we reported that many users of NMS did not receive adequate training.			
Maintenance	NMS is difficult to maintain because programmers developing the NMS software used ad hoc coding standards and these standards were inconsistently enforced resulting in numerous deficiencies in the code.			

The following sections summarize areas of noncompliance reported by OIG audits and USAID management assessments.

Accounting

In fiscal year 1996, USAID's net outlays totaled about \$5.3 billion. In order for the President, the Congress, and the public to have confidence that USAID is properly managing operations and reliably reporting results, the financial management system needs to incorporate federal accounting requirements. These requirements include an agency-wide classification structure, an integrated system, implementation of the SGL at the transaction level, applicable accounting standards, and JFMIP functional requirements.

Classification Structure

Federal financial management systems should collect, store, and retrieve financial data based on a standard agency-wide financial information classification structure. A standard structure requires that common data definitions and formats be used throughout the agency to accumulate financial and financially related information. The structure needs to support standard reporting requirements, allow consistent tracking of program expenditures, and cover financial and financially related information. A common classification structure minimizes data redundancy, ensures that consistent information is collected for similar transactions, encourages consistent formats for data entry, and ensures that consistent information is readily available and provided to managers at all levels. The classification structure needs to cover information needs for budget formulation, budget execution, programmatic, financial management, performance measurement, and financial statement and other reporting requirements.

USAID's financial management system, however, does not contain a consistent or complete classification structure. USAID currently relies on a combination of legacy systems, informal "cuff" records, and NMS. Because these systems do not contain standard data definitions or formats, USAID lacks a consistent agency-wide classification structure. In addition, the NMS does not include a complete classification structure. Although the new system was intended to maintain a common classification structure, USAID did not accomplish this goal. To be complete, a classification structure requires accounting events to be associated in several different ways in order to accumulate financial information for various purposes. For example, financial information needs to be reported by organizational unit, funding source, program or project. NMS, however, does not incorporate a project classification structure, which limits the systems' ability to accumulate financial information related to individual initiatives. Further, USAID did not provide adequate guidance to users to define how financial activities should be classified.

Unstructured classification of financial information contributes to increased data duplication, inconsistent information, the inability to support the agency's budget formulation and execution functions, inaccurate performance measurement information, and difficulties preparing reliable financial statements.

integrated Systems

Federal policy calls for each agency to implement an integrated financial management system. An integrated system does not mean a single all encompassing computer system that performs all financial functions. Instead, integrated means a unified set of systems that are planned, managed, and operated in an integrated manner, and linked electronically to carry out the agency's mission and support financial management needs. To be considered integrated, the system should use (1) a common classification structure (discussed above), (2) common transaction processing, (3) consistent internal controls, and (4) efficient transaction entry. An integrated system is important because it provides effective and efficient interrelationships between the software, hardware, personnel, procedures, controls, and data. For example, in an integrated system, data supporting an accounting event would normally be entered into the system once and then transferred electronically to update all accounts as required. This feature reduces data entry costs and the likelihood of errors from duplicate data entry.

USAID's financial management system, however, is not integrated. USAID currently relies on numerous incompatible formal and informal financial systems that are unable to share data. Even the newly deployed NMS is not an integrated system. For example:

- Inconsistent processing of similar transactions in two NMS components have resulted in differences between the general ledger balances and subsidiary ledger detail.
- NMS subsystems did not always transfer correct data, causing obligation and allowance data in NMS to be inaccurate. For example, a user entered four related transactions obligating a total of \$12,916 in the Acquisition and Assistance subsystem (A&A), but the total amount shown as obligated in the accounting subsystem was \$90,066. This situation illustrates that transactions were not being properly recorded, increasing USAID's vulnerability. Without accurate processing of critical financial transactions and events, USAID managers did not have reasonable assurance that the resources for which they were accountable were being used appropriately and in compliance with laws, regulations, and USAID policy.
- NMS lacked reliable monthly and year-end closing procedures including those for annual financial reporting due at the end of fiscal year 1997. Because NMS could not accommodate normal end-of-period closing requirements, manual procedures were implemented to attempt to provide

the necessary reports. However, monthly reports must be qualified because their accuracy cannot be assured. Further, end-of-year closing procedures are now not expected to be available until late in fiscal year 1998. These deficiencies prevent USAID from generating complete, reliable, timely, and consistent financial information.

Among other problems, the lack of an integrated system compromises controls over the funds availability function, increasing the risk that USAID may over-commit, over-obligate, or over-expend funds, resulting in Anti-Deficiency Act Violations. Also, lack of integration could result in reporting discrepancies between the amount of funds available, committed, obligated, or expended.

U.S. Government Standard General Ledger

The SGL establishes a standard set of accounts for financial reporting throughout the federal government. Agency financial management systems should record financial events following the requirements of the SGL at the transaction level. In order to ensure that government-wide financial information is consistent and reliable, all agencies need to process transactions following the definitions and defined uses of the accounts described in SGL. Compliance with this standard requires that (1) data in financial reports be consistent with the SGL, (2) individual transactions be recorded consistent with SGL rules, and (3) supporting transaction details for SGL accounts be readily available. Following the SGL enhances financial control and supports consistent internal and external reporting for the agency and the federal government.

USAID's financial management system does not implement the SGL at the transaction level. The lack of an integrated system causes heavy reliance on manual compilations of summary data from formal and informal systems to generate financial statements, rather than relying on systems to account for events in SGL formats. In fact, USAID's general ledger does not balance with subsidiary ledgers, a basic capability of any accounting system. In addition, accounts in the general ledger do not agree with detailed transaction data.

Deviation from the SGL requirements compromises USAID's ability to provide reliable financial data, thus increasing the risk that financial reports will not fairly portray USAID's financial condition or the results of operations. In addition, USAID lacks assurance that it provides adequate control over financial resources. USAID has identified two instances where it may have expended more funds than were available from appropriations. Although USAID financial managers believe that the problem is due to financial management system deficiencies rather than an actual violation, at this point, they do not know.

Federal Accounting Standards

Accounting standards provide rules for reporting financial information in financial statements. Federal Accounting Standards ensure that financial reports contain understandable, relevant, and reliable information about the financial position, activities, and results of operations for each agency and the U.S. Government as a whole. Generally, the federal government operates on an accrual basis of accounting. The federal government also has some unique accounting requirements. To standardize financial statement accounting practices, the Federal Accounting Standard Advisory Board (FASAB) develops and recommends adoption of federal accounting standards, which are issued by the Director of OMB. Agency systems need to incorporate these standards into their financial management systems to permit reporting in accordance with applicable accounting standards and other reporting requirements. When no accounting standard has been issued, agency systems can maintain and report data based on applicable accounting standards used by the agency for preparing its financial statements.

Currently, the FASAB has issued two accounting concepts covering (1) the objectives of federal financial reporting and (2) entity and display. The concept are:

- financial reporting focuses on the uses, user needs, and objectives of financial reporting by the federal government, and
- entity and display describes the basis for defining government organizations that should prepare financial statements. To be such an entity, the organization should have (1) a management responsible for controlling and deploying resources, producing outputs and outcomes, executing the budget, and being held accountable for the entity's performance; (2) financial statements that would provide meaningful representation of operations and financial conditions; and (3) the likelihood of interested users of the financial statements to help those users make resource allocation and other decisions, and hold the entity accountable for its deployment and use of resources.

In addition, four accounting standards were effective for fiscal year 1997, covering accounting requirements for:

- selected assets and I jabil ities.
- direct loans and loan guarantees,
- inventory and related property, and
- liabilities of the federal government.

USAID has reported that neither, NMS, nor the legacy systems, comply substantially with applicable federal accounting standards. During the audit of USAID's fiscal year 1997 financial statements, the OIG found that the financial management system does not implement an accrual methodology in accordance with federal financial accounting standards, federal system requirements, and generally accepted accounting principles. USAID implemented alternative manual methods, and is in the process of developing a new manual method for 1998.

For example, the OIG found that USAID's Advances and Prepayments balances may be materially overstated and the related expenditures may be materially understated. This occurred because the Office of Financial Management did not properly accrue expenditures in accordance with applicable federal accounting principles. Statement of Federal Financial Accounting Standard No. I require that Advances and Prepayments are reduced when goods or services are received...Advances should be initially recorded as an asset and should be subsequently reduced when expenses are actually incurred. Federal system requirements call for the financial management system to automatically generate these recurring accrual entries, but USAID's system does not have this capability.

Noncompliance with Federal Accounting Standards limits USAID's ability to provide financial reports with understandable, relevant, and reliable information about the financial position, activities, and results of operations. Also, because USAID implements a manual process, the reliability of the results is less certain, and USAID may spend more resources than needed to develop financial statements that comply with accounting standards.

Functional Requirements

Functional requirements for financial management systems are defined in a series of publications issued by the Joint Financial Management Improvement Program (JFMIP). These requirements describe in detail the functions each system must perform to meet financial management system requirements. The Framework for Federal Financial Management Systems, published in 1995, describes the requirements for developing an integrated financial management system. Core Financial System Reauirements, originally published in 1988 and revised in 1994 and 1995, describe detailed requirements for core accounting functions? In USAID, these have been referred to as the primary accounting functions. These functional requirements help ensure that financial management systems actually contain the features necessary to meet federal accounting and reporting requirements. OMB Circular No. A-127 calls for core accounting systems to be tested to ensure that they meet the JFMIP core requirements.

⁶ These include (1) core financial system management, (2) general ledger management, (3) funds management, (4) payment management, (5) receipt management, (6) cost management, and (7) reporting.

Other JFMIP requirements documents include:

- Personnel/Payroll System Requirements, May 1990;
- Travel System Requirements, January 199 1;
- Seized/Forfeited Asset System Requirements, March 1993;
- Direct Loan System Requirements, December 1993;
- Guaranteed Loan System Requirements, December 1993; and
- Inventory System Requirements, June 1995.

USAID's financial management system does not meet some important core accounting system requirements, including essential reporting requirements. In August 1997, a USAID contractor summarized NMS' compliance with JFMIP requirements and reported that the system met varying percentages of each of seven functional areas as shown below. However, because NMS has not been tested against these core requirements, additional deficiencies may exist.

FUNCTIONAL AREAS and REQUIREMENTS		COMPLIANT		
		Requirements Met	Per Cent	
Core Financial Management	43	22	5 1 %	
General Ledger Management	12	2	1 7%	
Funds Management	53	36	68%	
Payment Management	43	33	77%	
Receipt Management		27	75 %	
Cost Management	9	0	0%	
Reporting	17	5	29%	

To a large extent, deficiencies in meeting these requirements are reflections of the deficiencies cited in other requirement categories. By not meeting these functional

requirements, USAID is operating a system that does not perform key functions required of federal financial management systems.

Reporting

Reporting involves summarizing reliable information on financial, performance, and budget matters and making that information readily available to users inside and outside the agency. In enacting the FFMIA into law, the Congress found that the accountability and credibility of the federal government must be rebuilt and public confidence in it must be restored. In short, agencies and managers must be able to provide information that is essential to monitor budgets, operations, financial results, and program performance.

A key purpose of federal financial management systems is to report financial, performance, and budget information, so that agency programs and activities can be considered and evaluated based on their full costs and merit. Agency management, the President, the Congress, and citizens need access to complete, reliable, timely, and consistent information generated from agency financial management systems.

Federal laws and executive branch policies require agencies to develop and maintain integrated systems for reporting program results and related funding. Examples of these laws and regulations include:

- Office of Management and Budget Circular No. A-127 (Revised), <u>Financial Management Systems</u>, states that "...each agency shall establish and maintain a single, integrated financial management system...[and] the agency financial management system shall be able to provide financial information in a timely and useful fashion."
- The Chief Financial Officers Act of 1990 (section 902.[a][3] [D] [iv]) states: "An agency CFO shall develop and maintain an integrated agency accounting management system which provides for systematic measurement of performance."
- Office of Management and Budget Bulletin No. 93-02 states: "Whenever possible financial data should be related to other measures of performance on a programby-program basis. The inclusion of performance measures will facilitate using the financial statement to assess both financial and program performance."

USAID has not yet met the above requirements. USAID in its fiscal year 1997 Integrity Act report identified the lack of an effective, integrated financial management system as a material weakness. The report stated that the system does not meet some important financial management system requirements, such as being capable of producing all

required financial reports and other management information at an acceptable level of timel iness and accuracy.

USAID has not developed and maintained an integrated system for reporting program results and related funding and is currently unable to meet many of its reporting requirements. In our March 1997 report on the Worldwide Deployment of NMS, we found USAID's primary accounting system-AWACS-did not generate accurate financial or management information, including basic Treasury reports. Further, the premature deployment of AWACS resulted in fragmented accounting records, further reducing USAID's ability to prepare financial and management information. Because of these deficiencies:

- USAID has been unable to present required reports describing the status of program operations. To illustrate, officials from USAID's Bureau for Europe and New Independent States (ENI) and the State Department told us they were not able to provide accurate and timely financial and management reports to Congress. The officials stated that they were not able to report on activities under the Freedom Support Act for the quarter ended December 31, 1996. They attributed the problems to NMS's inability to provide needed financial information. As a result, neither ENI nor State Department officials believed they could reliably report how much was being spent on the Program or that the funds were spent effectively.
- Because the financial management system does not include the required managerial cost accounting component, managers are unable to reliably accumulate prior or projected program or project costs. To illustrate, in June 1996, USAID reported to OMB that the NMS would cost \$86.9 million. Our review of supporting cost information, however, indicated that NMS costs could exceed \$96.4 million. Further, based on deficiencies in USAID's accounting records, we concluded that costs incurred could be higher than identified in USAID's supporting documents.
- As we reported in the fiscal year 1997 financial statement audit, USAID has reported inconsistent information on unobligated balances to the Department of Treasury and to the OMB. These reports were made on the Treasury Financial Management Service's form 2 108, Year-End Closing Statement, and OMB's Standard Form 133, Report on Budget Execution. Our March 1997 report pointed out that NMS was unable to generate either report. OMB personnel told us that they were concerned with the materiality of the differences-more than \$143 million-between USAID's reports to Treasury and OMB

The lack of a compliant integrated accounting and financial management system inhibits USAID's ability to relate (1) obligations and expenditures to USAID's overall strategic goals and objectives, and in support of each operating unit's strategic objective and

intermediate results; and (2) program results to budget components included in its financial statements. This in turn impairs USAID's ability to manage for results and to report results in relation to funding.

Controls

Management controls are the organization, policies, and procedures used by agencies to reasonably ensure that (1) programs achieve their intended results; (2) resources are used consistent with agency mission; (3) programs and resources are protected from waste, fraud, and mismanagement; (4) laws and regulations are followed; and (5) reliable and timely information is obtained, maintained, reported, and used for decision making. Federal requirements call for adequate internal and computer security controls, which should be essential elements in the design and operation of financial management systems.

Internal Controls

A subset of management controls are the internal, controls used to assure that there is prevention or timely detection of unauthorized acquisition, use, or disposition of assets. Laws dealing with internal controls include the (1) Accounting and Auditing Act of 1950 which established requirements for an effective internal control system, and (2) Federal Managers' Financial Integrity Act of 1982 which reinforced the need for effective internal controls.

Federal financial management system requirements for internal controls call for the system to include internal controls that ensure resources use is consistent with law, regulations, and policies; resources are safeguarded against waste, lo-s, and misuse; and reliable data are obtained, maintained, and disclosed in reports. GAO has established guidance for internal controls in their publication Standards for Internal Controls in The Federal Government. The following table shows the areas addressed by the GAO general and specific standards for internal controls in the federal government.

GAO	Internal	Control	Standa	rds
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General Standards	Specific Standards			
Reasonable Assurance Internal control systems are to provide reasonable assurance that the objectives of the system will be accomplished.	Internal control systems and all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination.			
Supportive Attitude Managers and employees are to maintain and demonstrate a positive and supportive attitude toward internal controls at all times.	Recording of Transactions and Events Transactions and other significant events are to be promptly recorded and properly classified.			
3. Competent Personnel Managers and employees are to have personal and professional integrity and are to maintain a level of competence that allows them to accomplish their assigned duties, as well as understand the importance of developing and implementing good internal controls.	3. Execution of Transactions and Events Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority.			
4. Control Objectives Internal control objectives are to be identified or developed for each agency activity and are to be logical, applicable, and reasonably complete.	Separation of Duties Key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be separated among individuals.			
5. Control Techniques Internal control techniques are to be effective and efficient in accomplishing their internal control objectives.	Supervision Qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved.			
	6. Access to and Accountability for Resources Access to resources and records is to be limited to authorized individuals, and accountability for the custody and use of resources is to be assigned and maintained. Periodic comparison shall be made of the resources with the recorded accountability to determine whether the two agree. The frequency of the comparison shall be a function of the vulnerability of the asset.			

USAID's financial management system does not include a system of internal controls that meets GAO's standards for internal control. In September 1997,' we reported that the **NMS** does not include a system of internal controls that meets GAO's <u>Standards for Internal Controls in the Federal Government</u>. Among other things, internal control objectives were not identified and internal control techniques were not documented. As a result, USAID managers cannot reasonably ensure that the control techniques they have implemented are effective.

Without adequate internal controls USAID managers are unable to provide reasonable assurance that program goals and objectives are met; resources are adequately safeguarded; reliable data are obtained, maintained and reported; and activities comply with laws and regulations. Because of this situation, USAID faces significant risks and increased vulnerability, known and unknown, to fraud, waste, and abuse; and compromise of sensitive, Privacy Act-protected information as a result of relying on NMS to account for and provide management information on the use of resources and program operations.

Computer Security

Computer security requirements comprise a subset of an organization's overall internal controls. These particular controls are intended to protect the integrity of sensitive information which is stored in computer systems. However, computer security requirements are often addressed separately from other internal controls. This separation is due to the technical complexity involved in securing computers and the agency's increasing reliance on computers to store and process information.

Among the significant laws and guidelines requiring agencies to maintain an effective computer security program are the Computer Security Act of 1987 and OMB Circular No. **A-I** 30, Appendix III, "Security of Federal Automated Information Systems." Specifically:

- the Computer Security Act requires federal agencies to protect information by: (1) identifying sensitive systems, (2) developing and implementing security plans for sensitive systems, and (3) establishing a training program to increase security awareness and knowledge of accepted security practices.
- Appendix III of OMB Circular A-130, which implements the requirements of the Computer Security Act, directs agencies to establish a security program and maintain an adequate level of security for sensitive systems and information.

' Audit Report No. A-000-97-009-P, Audit of the Internal Controls for the Operational New Management System, September 30, 1997.

The increasing complexity of technology and the proliferation of computers have resulted in a greater commitment of resources to computer operations and a wide range of computer applications. USAID makes extensive use of information technology in serving the public and managing resources while executing its programs. However, The increasing reliance on computers leaves USAID exposed to the risk of unauthorized modification of data; destruction of computer resources; disruption of operations; and compromise or loss of resources, including sensitive agency information.

In September 1997, we reported that USAID had not implemented an effective security program that met the requirements of the Computer Security Act of 1987 or OMB Circular No. A-I 30.8 Security requirements and practices that USAID had not implemented included: assigning security responsibilities, providing adequate security training to responsible officials, preparing security plans for sensitive systems, and conducting security reviews of systems to ensure that they are protected. These security weaknesses expose USAID to unacceptable risks that resources will not be adequately protected from fraud or misuse and that sensitive data and systems will not be adequately protected from loss or destruction.

Operations

Most computer system costs are incurred after the system becomes operational. Computer system operations include operating the system, responding to user questions and correcting routine defects, enhancing system capabilities to meet new requirements, and eventually, retiring the system. The **FFMIA** defines financial management systems to include not only the hardware and software needed to support financial management, but also the automated and manual processes, procedures, controls, data, and support personnel dedicated to the operation and maintenance of system functions. Federal requirements call for adequate documentation, training, and maintenance practices, which are important to ensure that the system continues to operate efficiently and effectively.

Documentation.

Federal financial management system requirements call for agencies to adequately document the system/software structure and capabilities, processing instructions for operating personnel, and operating procedures and manuals for users. To be fully useful, documentation should be kept up-to-date and be readily available for examination and use. The documentation also needs to be sufficiently detailed to permit responsible personnel to understand the system and its operations. Up-to-date documentation is

⁸ Audit of USAID's Compliance With Federal Computer Security Requirements (Report No. A-000-97-008-P, September 30, 1997).

needed so that users will be able to understand how to operate the system, technical personnel will be able to keep the system functioning effectively and efficiently, and system developers will be able to easily correct problems and implement enhancements.

USAID management recognizes that financial management system documentation is not complete or current. USAID has identified the lack of financial management procedures as a material control deficiency in its integrity Act reports since 1993. USAID also recognizes that system and requirements documentation for NMS is not complete, is not up-todate, and does not follow prescribed standards. These deficiencies have hindered efforts to support on-going system maintenance and operations.

Training and User Support.

Training is important to successful implementation and ongoing operation of a financial management system. Without proper training, users of a system may erroneously enter data, operators may make errors that disrupt system operations, and developers may have difficulty implementing new requirements. Federal financial management system requirements call for agencies to provide adequate training and appropriate support—based on the level of responsibility and roles of individual users-to enable the users of the system at all levels to understand, operate, and maintain the system efficiently and effectively. This requires implementation of a comprehensive training program for system developers, computer operators, and users.

USAID, however, has not implemented an effective training program. For example, NMS was deployed without providing the necessary training to users. In response to a February 1997 questionnaire we sent to NMS overseas sites, only about one-third of respondents stated that they had been fully trained on NMS version 4-the version deployed in October 1996. Eleven of 38 people responding to this question stated that they had received training on NMS version 4. Ten stated that either part of the staff had been trained on version 4 or that the staff had been trained on part of version 4. The remaining staff had either not been trained (11), were self-taught (4), or had been trained on an earlier version of NMS (2). One person who had been trained on the entire version 4 stated that, "... with 14 updates [at the time of the response], it is like being trained on a moving target."

The lack of an effective training program prior to the deployment of the new system has contributed significantly to user problems.

Maintenance.

On-going system maintenance needs to be performed to enable the system to continue operating effectively and efficiently. Agencies should periodically evaluate how well the system supports changing business practices and make appropriate modifications through its maintenance program.

USAID however has limited capacity to manage its information resources, including meeting the maintenance requirements of its systems. It is currently assessed as a level 1 organization on the Software Engineering Institute (SEI) Capability Maturity Model (CMM) scale. This is the lowest level and means that USAID does not have the capacity to maintain its systems.

This leaves the agency vulnerable by not being able to effectively change the system to meet new requirements or address critical new problems, such as the year 2000 problem that will require all agency computer programs to be reviewed.

Management Comments and Our Evaluation

On February 27, 1997, the Acting Assistant Administrator for Management provided written comments on a draft of this report. The Acting Assistant Administrator agreed that USAID's financial management system does not comply with federal requirements. He pointed out that USAID management is currently reviewing options to implement a system that meets federal requirements, based on recommendations contained in a report prepared by the Federal Systems Integration and Management Center, a component of the General Services Administration. Management's comments are reproduced in Appendix II.

SCOPE AND METHODOLOGY

Scope

Our review of USAID's compliance with the requirements of the Federal Financial Management Improvement Act of 1996 included determining whether USAID's financial management system complies substantially with federal requirements for financial management systems, applicable federal accounting standards, and the United States Standard General Ledger at the transaction level, as required by Section 803(a) of the Federal Financial Management Improvement Act of 1996.

The scope of our work included those financial management systems which were operational in USAID during fiscal year 1997. We relied heavily on assertions made by USAID's management in the Federal Managers' Financial Integrity Act Report for fiscal year 1997 and audit reports we issued during fiscal year 1997 that related to compliance with financial management system requirements.

This audit was conducted between December 1, 1997, and February 23, 1998 in accordance with generally accepted government auditing standards. Field work was conducted at Managua, Nicaragua; Guatemala City, Guatemala; Nairobi, Kenya; and Washington, D.C.

Methodology

We reviewed audit reports covering financial management issues during fiscal year 1997, as well as USAID documents describing financial management system capabilities and deficiencies. USAID documents included the assertions made by USAID management in the Federal Mangers' Financial Integrity Act Report for fiscal year 1997, dated December 31, 1997. We reviewed our prior audit findings as they related to compliance with financial management system requirements. We also reviewed internal USAID management assessments of both NMS and legacy systems and a comprehensive external analysis of NMS conducted, at USAID's request, by the Federal Systems Integration and Management Center, a component of the General Services Administration.

Because current information about mission financial management systems was limited, we also conducted tests of the Mission Accounting and Control System (MACS) in Managua, Nicaragua; Guatemala City, Guatemala; and Nairobi, Kenya. MACS is the primary system used by USAID missions to account for their activities.



FEE 2 7 1993

MEMORANDUM

TO: Theodore Alves, IG/A/IT&SA

FROM: Richard Nygard, A-AA/M

SUBJECT: Draft Audit Report on USAID's Compliance with the Requirements of the

Federal Financial Management Improvement Act of 1996

Thank you for the opportunity to comment on the subject report. As you have correctly outlined in the draft report, we have had significant difficulties on a wide range of issues related to the design, development and implementation of the financial and management information systems, collectively known as the New Management System (NMS). The lack of a single, integrated financial management system was first identified as a material weakness for USAID in 1988. The USAID Worldwide Accounting and Control System (AWACS) was developed as a component of NMS, as an integrated computer-based corporate information system. After a series of technical problems associated with the worldwide implementation, the AWACS module was suspended in field missions in 1997.

As you correctly stated, the last AWACS version did not comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. Together, we both have identified internal control deficiencies and other vulnerabilities associated with the development and deployment of NMS, particularly AWACS. Late last year an agreement was signed with the Federal Systems Integration and Management Center (FEDSIM) to conduct an independent verification and validation (IV&V) of NMS. FEDSIM has just finished its review of our financial management systems to evaluate (1) compliance with the Federal Financial Management Improvement Act (FFMIA), (2) progress towards USAID's goal for a worldwide accounting system that captures transactions when and where they occur; and (3) the ability to provide accurate and timely management information. The Agency is now reviewing options on the lowest management risk and cost alternative to meet its financial management system requirements based on the FEDSIM report.

Your report will serve **as** a major resource in our decision and planning **process** in meeting out financial **management** system goals and responsibilities and also acts as a baseline in gauging our **future performance**. We appreciate your assistance in the past and **look forward to working with you and your staff in a continued collegial** and cooperative **manner in the** development of the Agency's **new** integrated **financial** and management information systems.

LIST OF REPORTS THAT IDENTIFIED DEFICIENCIES

Audit of the Worldwide Deployment of the New Management System (NMS) (Report No. A-000-97-004-P, March 3 1, 1997)

Audit of USAID's Efforts to Resolve the Year 2000 Problem (Report No. A-000-97-005-P, July 11, 1997)

Audit of *USA/D's Compliance with* Federal Computer Security Requirements (Report No. A-000-97-008-P, September 30, 1997)

Audit of the *Internal Controls for the* Operational New Management System (Report No. A-000-97-009-P, September 30, 1997)

Audit of the Status of USAID's New Management System (NMS) (Report No. A-000-97-01 O-P, September 30, 1997)

Reports on *USAID's* Financial Statements, *Internal* Controls, and Compliance for Fiscal Year 7996 (Report No. 0-000-97-001-C, dated February 24, 1997)

Audit of *USA/D's* Status *in Implementing the Government Performance Act of* 7993 (Report No. 9-000-97-003-P, dated September 30, 1997)

Second Survey Report on *USA/D's* Implementation of *the* Government Performance *Act of1* 993 (Audit Report No. 9-000-97-002-S, dated March 31, 1997)

Analysis of Alternatives with Regard to the New Management *System (NMS)* (FEDSIM Project Number: 97269IDO-03, February 2, 1998)

FMFIA Report To The President For Fiscal Year 7997 (USAID/MPI, December 3 1, 1997)

Report to Treasury of Overobligations (Information Memorandum to the Administrator USAID/M/FM, December 27, 1997)

A WACS *JFMIP* Requirements Assessment and *Compliance* Report (Information Management Consultants, August 27, 1997)

Semiannual Report to Congress on Audit Management *and Resolution* (USAID/MPI, April 1, 1997 Through September 30, 1997)

Year 2000 Compliance Assessment and Recommended Strategy (Mitretek Systems, November 6, 1997)

Independent Assessment of the NMS Deficiencies and Undesirable Practices (Mitretek Systems, November 14, 1997)

USAID NMS h-dependent Assessment-Findings and Recommendations (Mitretek Systems, December 3, 1997)